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[redacted]

Central Intelligence Agency

Washington, D.C. 20505

DATE 8/22/86 FILE

DOC NO GI M 86-20186

OIR 3

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14 August 1986

MEMORANDUM FOR: Rodney B. McDaniel
Executive Secretary to the National Security Council

SUBJECT: Saudi Arabia's Oil Policy: Implications for the United States [redacted] 25X1

Rod

In response to recent interest in Saudi oil policy, attached is our assessment of Riyadh's motives. In our judgment, Saudi oil policy is aimed at increasing near-term oil revenues, forcing producer discipline, ensuring a long-term market for Saudi oil, and squeezing Iran economically. We have no evidence to suggest Riyadh has targeted the United States. We believe the slowdown in the US oil sector is a consequence rather than a goal of the Saudi oil strategy. If you or members of your staff have questions concerning the report, please call [redacted] Chief, Strategic Resources Division, Office of Global Issues [redacted] 25X1 25X1

[redacted] 25X1

Richard J. Kerr
Deputy Director for Intelligence

Attachment:
Saudi Arabia's Oil Policy: Implications for the United States [redacted]
GI M 86-20186, August 1986 [redacted] 25X1

[redacted] 25X1

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SUBJECT: Saudi Arabia's Oil Policy: Implications for the United States [redacted] 25X1

OGI/SRD/EMB/[redacted](11 August 1986) 25X1

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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

8 August 1986

Saudi Arabia's Oil Policy: Implications for the United States

Summary

Faced with falling output and oil revenues, Saudi Arabia last year abandoned its role as OPEC swing supplier to recapture market share. In our judgment, the new Saudi strategy has several goals: to increase near-term oil revenues, force other producers to reduce output and ensure a long term market for Saudi oil. We have no evidence to suggest the Saudi policy was aimed at the United States. Indeed, we believe the negative impact on the petroleum industry in the United States is a consequence rather than a goal. Even so, an attempt by the Saudis to ensure a long-term market for their oil by allowing prices to fall will likely retard oil exploration and development in high-cost mature areas like the US. [redacted] 25X1

This memorandum was prepared by [redacted] Energy Markets Branch, Office of Global Issues, with a contribution from [redacted] Office of Near East and South Asian Analysis and [redacted] Office of Information Resources. The information contained herein is updated to 8 August 1986. Comments may be directed to [redacted] Chief, Energy Markets Branch [redacted]

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Saudi Arabia's Oil Policy: Implications for the United States

Saudi Oil Policy in Perspective

The US oil industry--like all other oil producers including Saudi Arabia--benefited from high prices in the 1970s. The high prices, however, caused non-Communist oil consumption to fall in response to conservation and substitution away from oil and spurred development of non-OPEC oil supplies and alternative fuels. To help maintain prices well above free market levels, Saudi Arabia--acting as OPEC's swing producer--reduced output. Last year, the market conditions set into motion by the artificially high prices in the 1970s eroded Riyadh's position, both economically and politically, on the world energy scene. Saudi oil output had declined from 10 million b/d to 2.2 million b/d last August. 25X1

New Policy Objectives

Faced with the prospect of having to reduce output further to maintain prices, the Saudis decided to abandon their role as OPEC's swing supplier and moved to recapture market share. In our judgment, the new Saudi strategy has several goals

- to increase near term oil revenues,
- to force other producers to reduce output, and
- to ensure a long-term market for Saudi oil.

We believe the Saudis probably hoped that prices would stabilize at about $15 per barrel--which would produce the minimum required revenues at their quota level of 4.35 million b/d--and assure Saudi Arabia's position as the world's largest oil exporter. Unwillingness by OPEC's other members to make room for higher Saudi exports, however, forced prices to fall even further. 25X1 25X1

Recent oil market developments are in line with the Saudi objectives. In particular, if OPEC countries abide by their recent production sharing agreement and cut output sharply, the Saudis will have succeeded in their campaign to force producer discipline. Riyadh's oil revenues also will be higher than they were when the Saudis embarked on their new strategy. Demand for oil, moreover, will likely continue to rise, albeit slowly. In our judgment, the Saudis probably want oil prices to stay in the high teens and Saudi Oil Minister Yamani--through OPEC's Long-Term Strategy Committee--intends to encourage OPEC to follow the course of low prices to increase demand for Saudi oil. 25X1

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Fallout from the Saudi Strategy on the United States

We have no evidence to suggest the Saudi policy was aimed at the United States. Indeed, we believe the negative impact on the petroleum industry in the United States is a consequence rather than a goal. Nevertheless, an attempt by the Saudis to ensure a long-term market for their oil by allowing prices to fall--regardless of the motive--will likely retard oil exploration and development in high-cost mature areas like the US. Just as the high prices in the 1970s spurred a substantial increase in drilling and domestic production, the recent price collapse has triggered a sharp decline in activity. Indeed, the number of active drilling rigs in the United States rose from about 1200 in 1973 to approximately 4000 in 1981 and dropped to 700 in recent months. 25X1

Over the longer term, lower oil prices will dampen conservation and substitution trends, boost oil demand and hasten a return to tight market conditions. With an expected decrease in indigenous oil supplies and rising demand, US import dependence especially from the Middle East will likely increase because two-thirds of non-Communist oil reserves are in the region, including one-fourth in Saudi Arabia. 25X1

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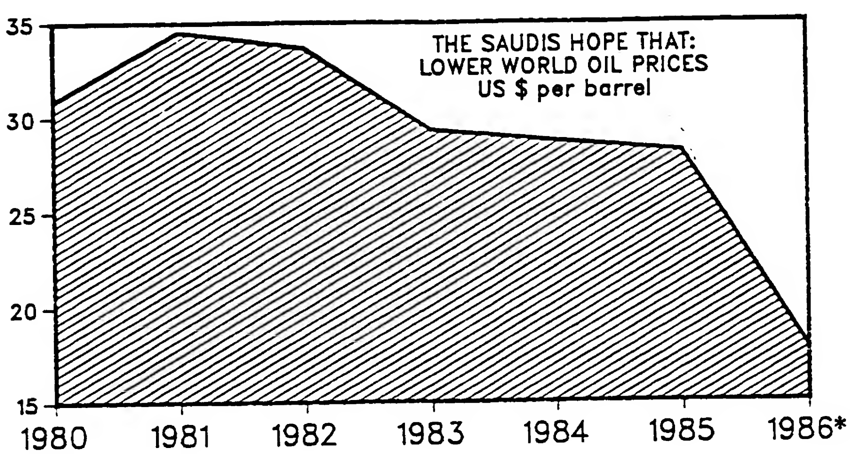

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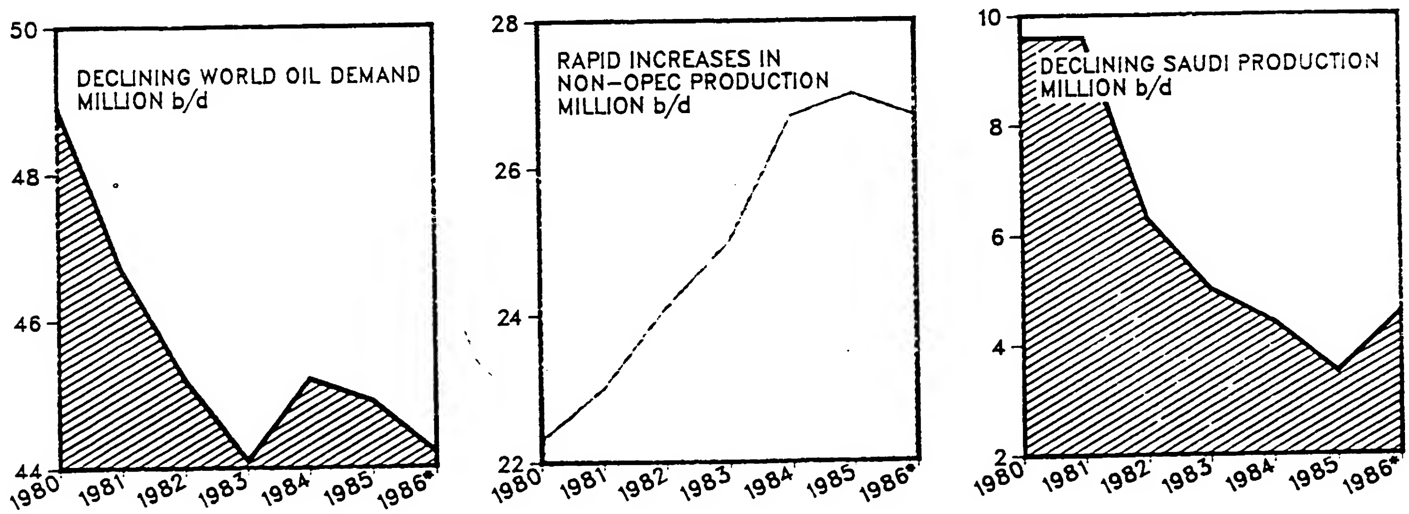

*DATA ARE FOR FIRST HALF 1986.